

REPORT OF EXAMINATION  
OF THE  
ANCHOR GENERAL INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2004

Participating State  
and Zone:

California

Filed March 24, 2006

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Los Angeles, California  
January 27, 2006

Honorable Alfred W. Gross  
Chairman of the NAIC Financial  
Condition Subcommittee  
Commissioner of Insurance  
Virginia Bureau of Insurance  
Richmond, Virginia

Honorable Gary L. Smith  
Secretary, Zone IV-Western  
Director of Insurance  
Department of Insurance, State of Idaho  
Boise, Idaho

Honorable John Garamendi  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Chairman, Director and Commissioner:

Pursuant to your instructions, an examination was made of the

ANCHOR GENERAL INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 10256 Meanley Drive, San Diego, California 92131.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2001. This examination covers the period from January 1, 2002 through December 31, 2004. This examination was conducted pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2004, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; business in force by states; loss experience; and sales and advertising.

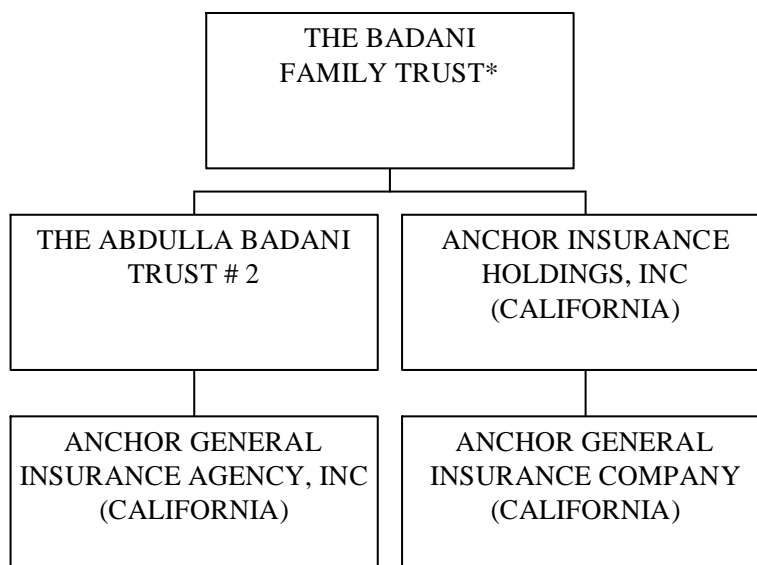
### COMPANY HISTORY

The Company was incorporated in Arizona under the name of Western Family Insurance Company, Inc. (Western Family), and commenced business during 1981. Effective January 1, 2001, the Company was sold to Mr. Abdulla Badani, the President and owner of Anchor General Insurance Agency, Inc. The purchase was made pursuant to a stock purchase agreement and approved by the Arizona Department of Insurance, the domiciliary state, and the California Department of Insurance (CDI), the state in which the Company was commercially domiciled. Effective October 1, 2001, the CDI approved the name change of the Company from Western Family to Anchor General Insurance Company and its redomestication from Arizona to California.

On December 19, 2005, Anchor Insurance Holdings, Inc. (AIHI), the Company's immediate parent, contributed \$4.4 million in cash to the Company in anticipation of increased premium writings over the next several years.

### MANAGEMENT AND CONTROL

The following organizational chart depicts the Company's relationship within the holding company system at December 31, 2004:



\*all ownership is 100%

Management of the Company is vested in a five-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2004 follows:

#### Directors

##### Name and Residence

##### Principal Business Affiliation

Abdulla Badani  
San Diego, California

President and Chief Executive Officer  
Anchor General Insurance Company

Tanzeem Reza  
San Diego, California

Vice President and Secretary  
Anchor General Insurance Company

Angie Van Cleaf  
San Diego, California

Vice President and Chief Financial Officer  
Anchor General Insurance Company

Susan Stokes-Gibson  
San Diego, California

Vice President  
Anchor General Insurance Company

Joe Kaiser  
San Diego, California

Vice President  
Anchor General Insurance Company

#### Principal Officers

<u>Name</u>	<u>Title</u>
Abdulla Badani	President and Chief Executive Officer
Tanzeem Reza	Vice President and Secretary
Angie Van Cleaf	Vice President and Chief Financial Officer
Susan Stokes-Gibson	Vice President
Joe Kaiser	Vice President

### Management Agreement

Program Administration Agreement: The Company, under its former owners, entered into a Program Administration Agreement with Anchor General Insurance Agency, Inc. (AGIA) on September 15, 1998. On January 1, 2001, the Company was purchased by its current owners making AGIA an affiliate. On January 1, 2001, a revised Program Administration Agreement with AGIA went into effect. The revised agreement was pre-approved by the California Department of Insurance (CDI) in October 2000. The agreement was also reported by the Company to the CDI in February 2001 in its Form B Holding Company filings. Under the terms of the agreement, AGIA provides services such as solicitation of risks, servicing the business, binding of risks, policy issuance, and the collection of premiums. AGIA is not responsible for obtaining reinsurance or the settlement of claims. AGIA receives 21.5% of net written premiums for these services. During 2002, 2003 and 2004, AGIA received \$4.4 million, \$5.2 million and \$8.1 million for these services, respectively.

### Cost Allocation Agreement

A Cost Allocation Agreement between the Company and its affiliate, Anchor General Insurance Agency, Inc. (AGIA) went into effect on December 1, 2003 and was approved by the CDI on April 6, 2004. Under the terms of this agreement, AGIA provides certain facilities and administrative services to the Company, both continuously and on an as-needed basis. Reimbursement for the services are calculated on a cost allocation/reimbursement basis in conformity with statutory insurance accounting practices, with no profit factor included in any cost or expense. During 2002,

2003 and 2004, total costs or expenses billed the Company by the affiliate, under the terms of this agreement, were \$581,498, \$753,311, and \$1,797,891, respectively.

### TERRITORY AND PLAN OF OPERATION

As of December 31, 2004, the Company was licensed to write various property and casualty coverages in Arizona, California, Nevada, New Mexico, and Texas.

In 2004, the Company wrote \$44 million of direct premiums with \$39.6 million in California, and \$2.4 million in Arizona. Approximately 96% of the direct premiums written were for non-standard private passenger automobile liability and physical damage coverages. The majority of policies written are offered at statutory minimum limits. Policies are marketed through Anchor General Insurance Agency, Inc., an affiliate, and produced by approximately 50 independent agents throughout California.

### GROWTH OF COMPANY

Since the last examination in 2001 through 2004, the Company's direct premiums written increased a total of 113%. Surplus as regards policyholders increased a total of 46% during the same period. The following is a breakdown by year for the examination period:

Year	Direct Premiums	Surplus
2001	\$20,645,705	\$8,210,487
2002	27,883,280	9,709,879
2003	33,166,126	10,444,101
2004	43,960,340	12,006,269

The Company's accelerated growth is the result of the absorption of three books of private passenger non-standard business from three separate companies.

## REINSURANCE

### Assumed

The Company does not assume business.

### Ceded

In 2002 the Company agreed to start writing a nonresident program at the request of Partner Reinsurance Company of the U.S. (Partner Re). Partner Re participates on all of the Company's automobile quota share treaties. The Company entered into an 80% quota share agreement with Partner Re in 2002. The Company decided to cease writing the nonresident program as the results did not meet its expectations. However, QBE Reinsurance Corporation (QBE) asked that the Company continue with the program on a 100% quota share basis. Effective September 1, 2004, the Company entered into a 100% nonresident automobile quota-share reinsurance agreement with QBE.

The liability of the reinsurers is subject to the following policy limits: bodily injury per person, \$100,000; bodily injury per accident, \$300,000; property damage per accident, \$50,000. Under the terms of the agreement, a provisional ceding commission of 18% is payable at a loss ratio of 72%. The agreement was terminated in April 2005 and the program is currently in runoff.

Effective January 1, 2004, the Company entered into a 55% quota-share reinsurance agreement. The primary reinsurers are Partner Reinsurance Company of the U.S (35%), TOA Reinsurance Company of America (10%), and Alea North America Reinsurance Company (10%). The liability of the reinsurers is subject to the following policy limits: bodily injury per person, \$15,000; bodily injury per accident, \$30,000; property damage per accident, \$10,000. Under the terms of the agreement, a provisional ceding commission of 21% is payable at a loss ratio of 68%. The commission is adjusted according to the loss ratio on a sliding scale basis subject to a minimum ceding commission of 18.5% and a maximum ceding commission of 29%.

The two quota-share agreements were reviewed by a Casualty Actuary from the California Department of Insurance and it was determined that the agreements meet the requirements of Statements of Statutory Principles (SSAP) 62 in regards to transfer of risk.

As of year-end 2004, the Company reported \$17.3 million in reinsurance recoverables from five authorized reinsurers. The reinsurance recoverable represents 144% of the Company's surplus as regards to policyholders.

### ACCOUNTS AND RECORDS

The prior examination included a recommendation that the management develop a business continuity plan in the event of a disaster. The Company reported that they don't have a business continuity plan but that they are in the process of developing one. It is again recommended that management allocate the necessary resources to achieve full adoption of the information systems business continuity plan, which would include testing the system and reviewing and coordinating the disaster recovery guidance for all departments.

### FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2004

Underwriting and Investment Exhibit for the Year Ended December 31, 2004

Reconciliation of Surplus as Regards Policyholders from December 31, 2001  
through December 31, 2004

Statement of Financial Condition  
as of December 31, 2004

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 5,381,177	\$ 0	\$ 5,381,177	
Cash, cash equivalents and short-term investments	9,817,192		9,817,192	
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	6,266,609		6,266,609	
Reinsurance: Amounts recoverable from reinsurers	3,371,378		3,371,378	
Net deferred tax asset	<u>222,005</u>		<u>222,005</u>	
Total assets	<u>\$ 25,112,066</u>	<u>\$ 0</u>	<u>\$ 25,112,066</u>	

Liabilities, Surplus and Other Funds

Losses		\$ 7,037,372	(1)
Loss adjustment expenses		1,251,173	(1)
Other expenses		84,622	
Taxes, licenses and fees		278,354	
Current federal and foreign income taxes		334,955	
Unearned premiums		97,959	
Ceded reinsurance premiums payable		3,851,529	
Amounts withheld or retained by Company for account of others		11,176	
Payable to parent, subsidiaries and affiliates		158,634	
Payable for securities		<u>23</u>	
Total liabilities		\$ 13,105,797	
Common capital stock	\$ 1,600,000		
Gross paid-in and contributed surplus	7,875,400		
Unassigned funds (surplus)	<u>2,530,869</u>		
Surplus as regards policyholders		<u>12,006,269</u>	
Total liabilities, surplus and other funds		<u>\$ 25,112,066</u>	

Underwriting and Investment Exhibit  
for the Year Ended December 31, 2004

Statement of Income

Underwriting Income

Premiums earned		\$ 19,483,425
Deductions:		
Losses incurred	\$ 10,231,519	
Loss expense incurred	2,440,696	
Other underwriting expenses incurred	<u>4,848,663</u>	
Total underwriting deductions		<u>17,520,878</u>
Net underwriting gain		1,962,547

Investment Income

Net investment income earned	\$ 237,139	
Net realized capital gains	<u>(19,900)</u>	
Net investment gain		217,239

Other Income

Aggregate write-ins for miscellaneous income	<u>\$ 101,295</u>	
Total other income		<u>101,295</u>
Net income before federal income taxes		2,281,081
Federal income taxes incurred		<u>763,400</u>
Net income		<u>\$ 1,517,681</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2003		\$ 10,444,102
Net income	\$ 1,517,681	
Change in net deferred income taxes	<u>44,486</u>	
Change in surplus as regards policyholders		<u>1,562,167</u>
Surplus as regards policyholders, December 31, 2004		<u><u>\$ 12,006,269</u></u>

Reconciliation of Surplus as Regards Policyholders  
from December 31, 2001 through December 31, 2004

Surplus as regards policyholders, December 31, 2001, per Examination			\$ 8,210,487
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$2,518,777	\$	
Change in net deferred income taxes	44,486		
Cumulative effect of changes in accounting principles		17,481	
Surplus adjustments: Paid-in	<u>1,250,000</u>	<u>          </u>	
 Totals	 <u>\$3,813,263</u>	 <u>\$17,481</u>	
 Net increase in surplus as regards policyholders			 <u>3,795,782</u>
 Surplus as regards policyholders, December 31, 2004, per Examination			 <u>\$12,006,269</u>

## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Losses and Loss Adjustment Expenses

Based on an analysis by a Casualty Actuary from the California Department of Insurance, the Company's loss and loss adjustment expense reserves as of December 31, 2004 were found to be reasonably stated and have been accepted for purposes of this examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Accounts and Records (Page 7): It is again recommended that management allocate the necessary resources to achieve full adoption of the information systems business continuity plan, which would include testing the system and reviewing and coordinating the disaster recovery guidance for all departments.

### Previous Report of Examination

Management and Control - Management Agreement (Page 4): As a means of facilitating compliance with California Insurance Code Section 1215.5, it was recommended that the parties formalize a cost sharing agreement. The Company has complied with this recommendation.

Accounts and Records (Page 7): It was recommended that management allocate the necessary resources to achieve full adoption of the information systems business continuity plan, which would include testing the system and reviewing and coordinating the disaster recovery guidance for all departments. The Company has not complied with this recommendation.

## ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and parent's employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/  
Samuel J. Salzman, CFE  
Examiner-In-Charge  
Senior Insurance Examiner  
Department of Insurance  
State of California